Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Oller	Analyst:	Colin Stevens	Bill Number:	AB 1365
Related Bills:	AB 1494 (1997/98) AB 2661 (1993/94)	Telephone:	845-3036	Introduced Date:	2/26/99
		Attorney:	Doug Bramhall	Sponsor:	

SUBJECT: Exclusion/Military Retirement, Disability or Other Benefit Received From Retirement From Armed Forces

SUMMARY

Under the Personal Income Tax Law (PITL), this bill would exclude from California gross income any military retirement pay, military disability pay, or any other benefits received from the armed forces by a person retired from the armed forces.

EFFECTIVE DATE

This bill would apply to taxable years beginning on or after January 1, 1999.

PROGRAM HISTORY

For taxable years beginning December 22, 1972, through January 1, 1986, **California law** provided a taxpayer an annual $1,000 income exclusion for salary, wages, bonuses, allowances and other compensation received during active duty in the Armed Forces of the United States or the State Military Reserve. California law also provided a taxpayer an exclusion of up to $500 a month for any compensation received during active duty in the National Guard in connection with an emergency. Also, an income exclusion applied to pensions or retirement pay received by an individual for his or her service in the Armed Forces of the United States, the State Military Reserve or the National Guard.

For taxable years beginning on or after January 1, 1987, and before January 1, 1992, **California law** provided a credit for taxpayers with adjusted gross income under $27,000 ($54,000 if both spouses qualified) equal to 4% of compensation for certain military income, subject to certain conditions. The maximum allowable credit limit was $40 per year and could not be carried over.

SPECIFIC FINDINGS

Existing federal and state laws provide that gross income includes all income from whatever source derived, including compensation, business income, gains from property, dividends, rents, interest, and royalties, unless it is specifically exempt.

Existing federal and state laws provide that certain types of income specifically are excluded from gross income, such as amounts received from certain death benefits, gifts and inheritances, compensation for injuries and sickness, qualified scholarships, educational assistance programs, and foster care payments.

Board Position:			Department Director	Date
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Under federal and state laws certain military benefits are excludable from income. These benefits include: benefits paid by the Veterans Administration such as disability compensation, pensions, educational assistance, etc. In addition, medical benefits, military disability benefits, various travel allowances and others paid by the military also may be exludable. Dislocation allowances, temporary lodging allowances and move-in housing allowances provided in permanent change of station also are excludable from income. Combat-zone compensation also is excludable, to certain maximum amounts.

Under current state and federal laws, a member of the armed forces of any country and the uniformed services of the United States may exclude from gross income the amounts received as pension, annuity or similar allowance for personal injury or sickness resulting from active service.

Under federal and state laws, gross income of a nonresident from sources within this state does not include any retired or retainer pay of a member or former member of a uniformed service computed under certain federal law (title 10 of the United States Code) that is received on or after January 1, 1996.

This bill would provide that gross income shall not include military retirement pay, military disability pay, or any other benefits received from one of the armed forces by a person retired from the armed forces may be excluded from gross income.

Policy Considerations

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

This bill would not provide a blanket exclusion of all income to military retirees and would not eliminate the filing requirement if military retirees receive other income subject to California tax, i.e. wages from civilian employment, gains from the sale of an asset, rental income, etc. In such cases, military retirees would continue to be subject to California tax although their retirement pay would be excluded from gross income when determining their tax liability. Therefore, this bill effectively lowers the rate of tax that would be applied to any other income received by the military retiree.

Implementation Considerations

The following implementation concerns have been identified. Department staff is available to assist the author in resolving these and other concerns that may arise.

This bill would not define "any other benefits received from one of the armed forces." Additional clarification as to benefits the author intends to exclude would assist the department. In some cases, a person may retire from the military, receive military retirement pay, and then work for the armed forces as a civil servant, arguably qualifying for exclusion from income under this bill.

According to the author's staff, the exclusion from income is intended to apply to Survivor Benefit Plan (SBP) annuities paid to the surviving beneficiaries of persons retired from the armed forces, as well as the individual who served in the armed forces. As introduced, the exclusion is limited to a person retired from the armed forces, and the bill would have to be amended to accomplish the author’s intent.

This bill would be effective upon enactment and would apply to taxable years beginning on or after January 1, 1999. Accordingly, the exclusion would apply to income already received.

Additional clarification as to the author’s intended definition for “armed forces” would assist the department, since the bill currently could include individuals who served in the armed forces of another country, the California National Guard or Coast Guard as well as the United States Army, Navy, Air Force and Marines.

This bill would not exclude from gross income benefits provided as an alternative to normal military retirement pay and benefits available after 20 years of active service, i.e. variable separation incentive (VSI) (a series of annual payments for a fixed period of years) and special separation benefit (a lump sum payment at the time of separation). For clarification purposes, the bill also should provide specific language describing any military retirement benefits that are intended to be excluded from income.

The bill provides an exclusion for certain pay and any benefits received by a person “retired from the armed forces.” The broad nature of benefits eligible for exclusion raises questions regarding the meaning of the term “retired from the armed forces,” which is not defined. Many benefits are provided to former members of the uniformed service. It’s unclear how the term “retired” would apply to a former member of the armed forces.

Technical Considerations

This bill does not define “military retirement pay.” Under federal law payments to retired members of the uniformed services include “retired pay” (including disability retired pay) and “retainer pay.”

This bill would exclude from income retirement pay or any other benefits paid to a person retired from the armed forces by the armed forces. Under the Revenue and Taxation Code, "persons" can include partnerships, fiduciaries, limited liability companies, corporations or individuals. The author may wish to amend the bill to specify that its provisions would apply to an individual.

FISCAL IMPACT

Departmental Costs

Once the implementation considerations are resolved, this bill is not expected to significantly impact the department.

Tax Revenue Estimate

Based on data and assumptions discussed below, the following revenue losses are projected to result from this proposal:

Estimated Revenue Impact of **AB 1365** As Introduced February 26, 1999 Assumed Effective From 1/1/99 With Enactment After 6/30/99 (In $Millions)			
Fiscal Years	1999/00	2000/01	2001/02
Revenue Impact (Rounded)	**(235)**	**(200)**	**(210)**

This analysis assumes that the bill will be amended to allow surviving to qualify for the exclusion. Any possible changes in employment, personal income, or gross state product that might result from this provision are not taken into account.

Tax Revenue Discussion

Revenue losses would depend on the amount of qualified military payments received in any given year for which state income taxes are paid.

According to available data from the Statistical Abstract of the United States (1996), total qualified military payments (U.S.) were $26.4 billion in 1994. This value was increased 5% annually for a 1999 projection of $33.7 billion and for years thereafter. From the same source, the number of military retirees living in California is nearly 11% of the national total. This percentage was used to project qualified military income to California residents ($3.7 billion for 1999).

This total amount was reduced 15% to allow for:
- current law exclusions for certain veterans compensation and
- recipients not incurring state income taxes.

A 6% average marginal tax rate was then applied to estimate the state revenue loss (on the order of $190 million for 1999).

The 1999/00 fiscal impact reflects all 1999 losses plus 25% of the year 2000 losses to allow for reduced estimated tax payments.

BOARD POSITION

Pending.